

Decatur Telephone Company
(A Wholly-owned Subsidiary of Decatur Holding Company)

Accountant's Report and Financial Statements

December 31, 2012



Decatur Telephone Company
(A Wholly-Owned Subsidiary of Decatur Holding Company)
December 31, 2012

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Independent Accountant's Report

Board of Directors
Decatur Telephone Company
(A Wholly-Owned Subsidiary of Decatur Holding Company)
Decatur, Mississippi

We have reviewed the accompanying balance sheet of Decatur Telephone Company as of December 31, 2012, and the related statements of operations and comprehensive income, stockholder's equity and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

Jackson, Mississippi
October 30, 2013

Decatur Telephone Company
(A Wholly-owned Subsidiary of Decatur Holding Company)

Balance Sheet
December 31, 2012

Assets

Current Assets

Cash and cash equivalents	\$ 48,104
Marketable securities	1,344,110
Accounts receivable	
Telecommunications customers, net of allowance of \$1,000	128,961
Other, principally connecting companies	135,946
Materials and supplies inventories	32,884
Prepayments and other	48,469

Total current assets	1,738,474
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Deferred Income Taxes	67,985
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Telecommunications Plant in Service	8,635,531
Less accumulated depreciation	(7,230,164)
	1,405,367

Total assets	\$ 3,211,826
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Liabilities and Stockholder's Equity

Current Liabilities

Accounts payable	\$ 19,230
Payable to affiliates	449,281
Customer deposits and advance billings	118,272
Other liabilities	1,495
	<hr/>
Total current liabilities	588,278
	<hr/>

Stockholder's Equity

Common Stock, \$100 par value; authorized 500 shares, issued and outstanding 460 shares	46,000
Accumulated other comprehensive income	47,043
Retained earnings	2,530,505
	<hr/>
Total stockholder's equity	2,623,548
	<hr/>
Total liabilities and stockholder's equity	\$ 3,211,826
	<hr/> <hr/>

Decatur Telephone Company
(A Wholly-owned Subsidiary of Decatur Holding Company)
Statement of Operations and Comprehensive Income
Year Ended December 31, 2012

Operating Revenues

Basic local services	\$ 324,931
Long distance and access charges	804,227
Miscellaneous	16,181
Uncollectible revenues	(14,434)
	<u>1,130,905</u>

Operating Expenses

Plant specific operations	272,611
Plant nonspecific operations	263,391
Depreciation and amortization	218,596
Customer operations	210,093
Corporate operations	585,658
	<u>1,550,349</u>

Operating Taxes

Income taxes	(143,896)
Other operating taxes	12,001
	<u>(131,895)</u>

Operating Loss

(287,549)

Other Income (Expenses)

Investment income	72,645
Income from nonregulated operations	261,064
Income taxes	(87,175)
Other, net	325
	<u>246,859</u>

Loss Available for Fixed Charges

(40,690)

Fixed Charges - Interest on Long-term Debt

18

Net Loss

(40,708)

Other Comprehensive Income, Net of Tax

50,368

Comprehensive Income

\$ 9,660

Decatur Telephone Company
(A Wholly-owned Subsidiary of Decatur Holding Company)
Statement of Stockholder's Equity
Year Ended December 31, 2012

	Common Stock Shares	Par Value	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance January 1, 2012	460	\$ 46,000	\$ (3,325)	\$ 2,571,213	\$ 2,613,888
Net loss	-	-	-	(40,708)	(40,708)
Other comprehensive income, net of tax	-	-	50,368	-	50,368
Balance, December 31, 2012	<u>460</u>	<u>\$ 46,000</u>	<u>\$ 47,043</u>	<u>\$ 2,530,505</u>	<u>\$ 2,623,548</u>

Decatur Telephone Company
(A Wholly-owned Subsidiary of Decatur Holding Company)
Statement of Cash Flows
Year Ended December 31, 2012

Operating Activities

Net loss	\$ (40,708)
Items not required (providing) cash	
Depreciation and amortization	218,596
Deferred income taxes	75,751
Gain on sale of marketable securities	(7,890)
Changes in operating assets and liabilities	
Accounts receivables	(159,265)
Materials and supplies inventories	553
Prepayments and other	(20,527)
Accounts payable	(86,046)
Customer deposits and advance billings	12,046
Other liabilities	(21,511)
	<hr/>
Net cash used in operating activities	<hr/> (29,001) <hr/>

Investing Activities

Additions to plant, net of salvage	(261,306)
Proceeds from sale of marketable securities	236,343
	<hr/>
Net cash used in investing activities	<hr/> (24,963) <hr/>

Financing Activities

Principal payments on debt	<hr/> (12,938) <hr/>
Net cash used in financing activities	<hr/> (12,938) <hr/>

Decrease in Cash and Equivalents (66,902)

Cash and Cash Equivalents, Beginning of Year

115,006

Cash and Cash Equivalents, End of Year

\$ 48,104

Decatur Telephone Company
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Notes to Financial Statements
December 31, 2012

Note 1: Organization and Summary of Significant Accounting Policies

Reporting Entity and Nature of Operations

Decatur Telephone Company (the Company) is a wholly-owned subsidiary of Decatur Holding Company. The accounting policies of the Company conform to accounting principles generally accepted in the United States of America and reflect practices appropriate to the telephone industry. The Company provides local telephone exchange carrier services in portions of Newton County, Mississippi. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The accounting records of the Company are maintained in accordance with the Uniform System of Accounts prescribed by the Federal Communications Commission (FCC) and the Mississippi Public Service Commission (MPSC).

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2012, cash equivalents consisted primarily of a certificate of deposit.

At December 31, 2012, the Company's interest-bearing cash accounts did not exceed federally insured limits.

Pursuant to legislation enacted in 2010, the Federal Deposit Insurance Corporation (FDIC) fully insured all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are subject to the \$250,000 limit on FDIC insurance per covered institution.

Decatur Telephone Company
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Notes to Financial Statements
December 31, 2012

Accounts Receivable

The Company generally grants credit to all customers. In certain cases, a deposit may be collected prior to the provision of service. Management records an allowance for estimated uncollectible accounts based on historical bad debt experience and other factors. Accounts are written off when collection is determined to be unlikely.

Materials and Supplies Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Property, Plant and Equipment

Telecommunications plant in service is stated at original cost of construction, including capitalized costs such as taxes and payroll-related expenses.

Depreciation

Depreciation on telecommunications plant is provided using the composite straight-line method using rates approved by the MPSC. Renewals and betterments of units of property are charged to telecommunications plant in service. The original cost of depreciable property retired, together with removal cost, less any salvage value realized, is charged to accumulated depreciation. No gain or loss is recognized with ordinary retirements of depreciable property. Repairs and renewals of minor items of property are charged to maintenance expense.

Long-lived Asset Impairment

The Company evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the

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Notes to Financial Statements
December 31, 2012

asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the year ended December 31, 2012.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance (Accounting Standards Codification [ASC] 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50%; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Revenue Recognition

Revenues are recognized when earned, regardless of the period in which they are billed. Telephone toll and access services are furnished in conjunction with AT&T and various interexchange carriers.

Local service revenues include revenues derived from the provision of basic flat rate message service; enhanced services such as call waiting, call forwarding and touchtone services; certain nonrecurring charges such as central office line connection charges; and revenues derived through messages which originate or terminate in the Company's service area through the provision of elective measured extended area calling plans.

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The interstate access charges are based upon tariffs filed by the National Exchange Carrier Association (NECA) with the FCC on behalf of member companies. These access charges are billed by the Company to the interstate interexchange carriers and pooled with like revenues from all NECA member companies. . The portion of the pooled access charge revenues received by the Company is based upon nationwide average schedule costs of providing interstate access service, plus a return on the investment dedicated to providing that service.

Compensation for intrastate-intralata and intrastate-interlata toll and access services is based upon access charge tariffs filed with the MPSC.

Taxes collected from customers and remitted to governmental authorities are presented in the accompanying statements of income and retained earnings on a net basis.

Current Economic Environment

The current protracted economic decline continues to present the business world with difficult circumstances and challenges, which, in some cases, have resulted in large and unanticipated declines in the fair value of investments and other assets, declines in the volume of business, constraints on liquidity and difficulty obtaining financing or bonding. The financial statements have been prepared using values and information currently available to the Company.

Current economic and financial market conditions could adversely affect our results of operations in future periods. The current instability in the financial markets may make it difficult for certain of our customers to pay their bills, which could ultimately have an adverse impact on future operations.

In addition, given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts receivable that could negatively impact the Company's ability to meet debt covenants or maintain sufficient liquidity.

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Notes to Financial Statements

December 31, 2012

Note 2: Investment in Marketable Securities

Marketable securities, consisting principally of municipal bonds and mutual funds whose underlying investments are government bonds, are reflected as available-for-sale securities and are stated at fair market value at December 31, 2012, based on published market prices. The following provides an analysis of net unrealized gain on marketable securities available for sale.

Investment in municipal bonds at cost	\$ 1,105,727
Unrealized gain	60,503
Investment in mutual funds at cost	171,110
Unrealized gain	<u>6,770</u>
Investment in marketable securities at year-end at fair value	<u><u>\$ 1,344,110</u></u>

The following provides an analysis of accumulated other comprehensive income (loss) component of stockholder's equity.

Unrealized gain on marketable securities available for sale	\$ 67,225
Deferred income taxes applicable to unrealized gain	<u>(20,182)</u>
	<u><u>\$ 47,043</u></u>

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Notes to Financial Statements
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Note 3: Telecommunications Plant in Service

The major classes of telecommunications plant and their related straight-line depreciation rates are as follows:

	<u>Amount</u>	<u>Rates</u>
Land	\$ 6,865	-
Buildings	70,357	2.5%
Central office equipment	3,846,496	8.0 - 11.3%
Station connections	74,497	10.0%
Pole lines, cable and wire	3,658,362	2.1 - 7.4%
Furniture and office equipment	188,807	10.0 - 14.5%
Vehicles	342,247	16.0%
Tools and other work equipment	447,900	16.0%
	<u>\$ 8,635,531</u>	

Application of these rates has resulted in composite rates as applied to average depreciable telecommunications plant investment of 2.57% for 2012.

Note 4: Income Taxes

The Company, for income tax purposes, is included in the consolidated income tax return of Decatur Holding Company. For financial statement purposes, the Company computes its income tax by applying the statutory rate to its pretax income reported in the financial statements (separate return method).

For tax purposes, the Company uses accelerated depreciation. The income tax effects of the difference in book and tax depreciation have been recorded as deferred income taxes.

The Company files income tax returns in the U.S. federal jurisdiction and the state of Mississippi. With a few exceptions, the Company is no longer subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for years before 2009.

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The provisions (credits) for income taxes include these components.

Operating		
Current		
Federal	\$	(76,730)
State		(10,445)
		<u>(87,175)</u>
Deferred		
Federal		(49,925)
State		(6,796)
		<u>(56,721)</u>
Total operating		<u>(143,896)</u>
Other		
Current		
Federal		76,730
State		10,445
		<u>87,175</u>
Total other		<u>87,175</u>
Total income tax credit	\$	<u>(56,721)</u>

The components of net deferred tax assets and liabilities recognized in the accompanying balance sheet due to temporary differences follows.

Deferred tax liabilities	
Accelerated tax depreciation	\$ (121,276)
Unrealized gain on marketable securities	(20,182)
Deferred tax assets	
Net operating loss	<u>209,443</u>
Net deferred tax asset	<u>\$ 67,985</u>

At December 31, 2012, the Company had unused federal operating loss carryforwards of approximately \$583,000, which expire beginning in 2024.

No valuation allowance was considered necessary at December 31, 2012.

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Notes to Financial Statements
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Note 5: Pension Plan

The Company provides a simplified employee pension (SEP) plan for its employees. The Company may make, at its discretion, contributions up to 15% of all participants' gross wages on an annual basis. In 2012, the Company contributed \$15,494 to the plan.

Note 6: Related Party Transactions

During 2012, the Company provided services to an affiliate, including outside plant services, general office services and use of certain telecommunications equipment. Billings for these services totaled \$9,611.

In 2012, the Company paid a stockholder of Decatur Holding Company \$10,200 for rental of a building and land.

Note 7: Nonregulated Operations

The Company provides internet access to customers in the general vicinity of its local exchange area. Details of the nonregulated operations follow.

Internet access revenues	\$ 412,320
Internet expenses	<u>151,256</u>
	<u><u>\$ 261,064</u></u>

Although the Company has identified the principal revenues and expenses of nonregulated operations, certain interdependence and overlaps between regulated and nonregulated operations exist, particularly as to sharing of commercial office and administrative expenses. Accordingly, the information provided may not be indicative of the operating results of nonregulated activities conducted as an independent unit.

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Notes to Financial Statements
December 31, 2012

Note 8: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the inputs and valuation methodologies used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such assets pursuant to the valuation hierarchy.

Available-for-sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include investments in mutual funds.

Where quoted prices for similar assets or liabilities are available; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities, securities are classified in Level 2 of the valuation hierarchy. Level 2 securities include investments in municipal bonds

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. There were no Level 3 securities.

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Notes to Financial Statements

December 31, 2012

Recurring Measurements

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying balance sheet measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2012.

Fair Value Measurements Using				
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012				
Mutual funds	\$ 177,880	\$ 177,880	\$ -	\$ -
Municipal Bonds	1,166,230	-	1,166,230	-
	<u>\$ 1,344,110</u>	<u>\$ 177,880</u>	<u>\$ 1,166,230</u>	<u>\$ -</u>

Note 9: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Accountant's Report, which is the date the financial statements were available to be issued.